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In the Supreme Court of the United States

OCTOBER TERM, 1995

STONEHENGE INSURED NOTES-I LIMITED PARTNERSHIP, ET AL., PETITIONERS

v.

UNITED STATES DEPARTMENT OF THE TREASURY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the courts below correctly declined to impose a constructive trust in favor of petitioners on proceeds from the sale of an apartment by a debtor in bankruptcy.

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OPINIONS BELOW

The opinion of the court of appeals (Pet App. B1-B7) is unpublished, but the decision is noted at 47 F.3d 1157 (Table). The opinions of the district court (Pet. App. D1-D41) and the bankruptcy court (Pet. App. F1-F7) are unreported. Related opinions of the bankruptcy court are reported at 157 B.R. 528, 149 B.R. 310, and 97 B.R. 155.

JURISDICTION

The judgment of the court of appeals was entered on January 10, 1995. A petition for rehearing was denied on May 19, 1995. Pet. App. A1-A2. The petition for a

writ of certiorari was filed on August 17, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In May 1983, after some discussion of a possible investment in a New York City parking garage, petitioner Harbison-Fischer Mfg. Co., Inc. (HF) wired $1.5 million of corporate funds to the order of Philip Zinke. Although Zinke was the manager of HF's retirement plan, the wired funds belonged to the corporation, not to the plan. The funds were deposited in an account in the name of an association of which Zinke was president, and the next day $810,000 was transferred from that account to an account in the name of a corporation of which Zinke was also president. A check for $810,000 was drawn on that corporation's account and delivered as partial payment for the purchase, by Zinke and his wife, of a cooperative apartment at 1010 Fifth Avenue in New York City. Pet. App. D4, D6.

Petitioner Stonehenge Insured Notes-I Limited Partnership (Stonehenge) is a limited partnership of which Zinke was the general partner. In April and July 1984, Zinke drew two checks on Stonehenge's account for a total of $1.05 million, which he used as partial payment for the acquisition of a building in midtown Manhattan (the Famolare building). Pet. App. D5. In August 1984, HF, through Zinke, provided an additional $7.9 million for the purchase of the Famolare building, through a loan secured by a mortgage on the building. The loan and mortgage contained an "equity kicker"—that is, a provision giving HF, in addition to stated interest on the loan

amount, a share in any appreciation realized on the property's resale. Pet. App. D5; see C.A. App. 301-302.

Zinke executed two notes to HF that were prepared by HF's counsel: one dated as of May 31, 1983, for $1.5 million, and one dated as of October 1, 1984, for $1,753,868.44 (reflecting interest accrued on the $1.5 million from May, 1983). Pet. App. D7; see *id.* at D10. The second note was secured by an interest in the Famolare building. *Id.* at D7. In December 1984, HF sent Zinke a letter requesting payment of principal and interest totalling $1,790,452.24. *Id.* at D8.

In January 1985, Zinke arranged to refinance the Famolare building. HF received approximately $10 million in that transaction, including repayment of approximately $8.2 million in principal and interest then due on its secured loan. Pet. App. D8, D10-D12, D14. The refinancing agreement specifically provided that HF would retain its interest in any appreciation in the building's value, which therefore could not account for the additional $1.8 million that HF received. See *id.* at D10-D12. After the refinancing, HF made no further demand for the $1.8 million balance previously due on the Zinke notes. *Id.* at D11-D12.

2. Zinke's wife filed for bankruptcy in September 1987 and then commenced this adversary proceeding, seeking an order allowing her to sell the Fifth Avenue apartment free and clear of other claims and to use the proceeds to satisfy, among other things, federal and state tax liens. Pet. App. B3. HF and Stonehenge objected, each seeking to have the bankruptcy court impose a constructive trust in its favor against the proceeds from sale of the apartment. *Ibid.* HF claimed that Zinke had misappropriated the $810,000 of its funds that he used to purchase the

apartment, thereby breaching an alleged fiduciary duty. See *id.* at D21-D22, F3. Stonehenge, in turn, claimed that Zinke violated a fiduciary duty owed to it when he used $1.05 million of its funds to purchase the Famolare Building. *Id.* at D22. Although Stonehenge's funds were not used to acquire the Zinke apartment, Stonehenge argued that if HF's $1.5 million was repaid out of the proceeds of refinancing the Famolare Building, then Stonehenge's claim should be "substituted for or subrogated to HF's claim against the proceeds" from the apartment's sale. *Ibid.*; see *id.* at F3-F4.

The bankruptcy court rejected petitioners' claims. Pet. App. F1-F6. The court concluded that the $1.5 million advance from HF to Zinke was an ordinary commercial loan, evidenced by promissory notes prepared by HF's own counsel and ultimately repaid in full out of the proceeds from the refinancing of the Famolare building. *Id.* at F4, F7. On those facts, the court found that HF had failed to establish either a fiduciary relationship between it and Zinke, or any entitlement to the imposition of a constructive trust. *Id.* at F5, F7. Because Stonehenge's claim was based entirely on "subrogation" to HF's position, the failure of HF's claim also precluded recovery by Stonehenge. *Id.* at F5. In addition, the court noted that Stonehenge had failed to submit any evidence that Zinke had improperly converted any of its partnership funds. *Id.* at F5-F6.[1]

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[1] Zinke maintained that he had executed promissory notes relating to the $1.05 withdrawn from SIN-I's accounts, and that the SIN-I partnership agreement gave him the right to undertake such a transaction. See C.A. App. 297, 318-321; see also Pet. App. D5 n.5. As petitioners note (Pet. 5 n.1; see Pet. App. D5 n.5), Zinke was separately charged with grand

3. The district court affirmed. Pet. App. D1-D40. After a detailed review of the record (*id.* at D2-D17), the court agreed that the evidence supported treating the $1.5 million transfer from HF to Zinke as an ordinary loan transaction, and that HF "did not establish that it stood in a common law fiduciary relationship with Zinke." *Id.* at D24. The court also rejected (*id.* at D24-D25) HF's contention that Zinke was a "statutory fiduciary" to HF under the Employee Retirement Income Security Act of 1974 (ERISA). Acknowledging that Zinke might have been a fiduciary with respect to the HF retirement plan, which he managed, the court pointed out that the company and the plan were different entities, that the loan came from the company, and that "Zinke's possible fiduciary relationship with the Plan does not transform him into a fiduciary with respect to [HF] for purposes of * * * ERISA." Pet. App. D25.

The district court also concluded (Pet. App. D26-D29) that HF had failed to establish any other element that might have supported the imposition of a constructive trust. Because Zinke had unrestricted use of the funds, the court found no promise by Zinke to invest them on HF's behalf, nor any reliance upon such a representation in making the transfer. *Id.* at D26-D27. And because HF was repaid in full out of the proceeds of the Famolare building refinancing, there could be no finding that Zinke had been unjustly enriched by the loan transaction. *Id.* at D27-D28.

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larceny in connection with the diversion of the $1.05 million. His conviction was overturned on appeal on the ground that, as a matter of law, "in New York, partners cannot be charged with larceny for misappropriating firm assets." *People* v. *Zinke*, 556 N.Y.S.2d 11, 14 (1990), rev'g 146 A.D. 106 (1st Dep't 1989).

The district court similarly upheld the bankruptcy court's rejection of Stonehenge's constructive trust claim. Pet. App. D32-D34. In the absence of any record evidence concerning the Stonehenge limited partnership agreement, any other contractual relationship between Zinke and Stonehenge, or whether some or all of Stonehenge's limited partners were ERISA plans, the court "agree[d] with the bankruptcy court's conclusion that there was insufficient evidence in the record to support [Stonehenge's] claims that Zinke was an ERISA or common law fiduciary to [Stonehenge] and breached his fiduciary duty to [Stonehenge] by borrowing the $1.05 million from [Stonehenge's] account." *Id.* at D33. Moreover, the court noted that Stonehenge "has not disputed that its claim is dependent upon the establishment of a constructive trust by HF" (*id.* at D34), so that the rejection of HF's claims necessarily entailed the failure of Stonehenge's claim as well. *Ibid.*[2]

4. The court of appeals affirmed. Pet. App. B1-B7. The court found no clear error in the bankruptcy court's findings that the $1,500,000 transfer from HF to Zinke was a loan and that the loan was fully repaid, with interest, from the proceeds of refinancing the Famolare building. *Id.* at B4-B5. On the basis of those findings, the court of appeals affirmed the lower courts' holdings that petitioners "failed to prove

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[2] The district court also considered and rejected arguments that Zinke had defrauded HF (Pet. App. D29-D32), that the bankruptcy court had erred by refusing to enforce a settlement agreement under which Zinke's wife (the debtor) had purportedly agreed not to contest the constructive trust claims (*id.* at D34-D37), and that the bankruptcy court should have granted petitioners' motion for a new trial (*id.* at D38-D40). Petitioners do not renew those arguments in this Court.

either a fiduciary relationship or unjust enrichment," and concluded that "neither [lower] court abused its discretion in declining to impose a constructive trust" in favor of HF. *Id.* at B5. The court also rejected Stonehenge's claim. *Id.* at B5-B6. Because the partnership could not trace its funds to the Fifth Avenue apartment, its claim derived from and depended on HF's claim (*ibid.*); and because "[HF] failed to secure a constructive trust in its favor, [Stonehenge's] claim fails as well" (*id.* at B6).[3]

ARGUMENT

1. Petitioners purport to present five questions involving the Employee Retirement Income Security Act of 1974. Pet. i. Those questions, however, have little to do with the facts of this case as found by the lower courts. As the courts below uniformly concluded, Philip Zinke borrowed money from petitioner HF, a commercially sophisticated corporation with which he had no fiduciary relationship. Pet. App. B3-B4, D22-D25, D28, F4-F5. Zinke used some of that money to buy an apartment. *Id.* at B3. He later repaid the loan, using proceeds from the refinancing of a building in which he held an equity interest. *Id.* at B4-B5. That interest was acquired in part with funds that Zinke obtained, under unclear circumstances (see *id.* at D5 & n.5), from petitioner Stonehenge, of which he was the general partner. That sequence of events raises squarely the common-law questions of fiduciary duty, misappropriation, and constructive trust that were considered and resolved by the courts below. It raises no issue under ERISA.

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[3] The court of appeals also rejected petitioners' claim that they were entitled to a new trial. Pet. App. B6-B7.

Petitioners attempt to bring their claims within the purview of ERISA by alleging (i) that Zinke was the investment manager of petitioner HF's pension plan (Pet. 6) and (ii) that the HF plan "and other pension plans" were limited partners in petitioner Stonehenge (Pet. 6, 11). As the courts below correctly held, however, the first point is irrelevant, because whatever relationship Zinke had with HF's pension plan did not make him an ERISA fiduciary of the company itself, and it was from the company that he borrowed the money used to purchase his apartment. Pet. App. B3-B4, D24-D25.

With respect to the second point, the district court reviewed the record and found that Stonehenge had failed to produce a copy of its own limited partnership agreement, any other evidence of the contractual relationship between the partnership and Zinke, or any evidence establishing that the limited partners were plans covered by ERISA.[4] Pet. App. D33. Under the circumstances, the courts below were fully justified in rejecting (*id.* at D24-D25, D33) petitioners' attempt to characterize Zinke as an ERISA fiduciary with respect to either HF or Stonehenge. That fact-bound determination warrants no further review, and its acceptance leaves no basis in the record for consideration of the questions that petitioners ask this Court to resolve.[5]

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[4] Petitioners offer no citation for their assertion (Pet. 11) of an "admission by Zinke that he was an ERISA fiduciary to * * * pension plans that were limited partners of Stonehenge." Compare Pet. App. D33.

[5] Petitioners argue (Pet. 12-14) that even if Zinke was not a fiduciary of HF, he could be liable "as a party-in-interest and a non-fiduciary for knowing participation in a breach of his [own] fiduciary duties with respect to Stonehenge funds." Pet. 14.

2. The court of appeals correctly upheld the lower courts' conclusion that petitioners failed to establish their entitlement to a constructive trust. The evidence reviewed by the bankruptcy court (Pet. App. F4-F6) and the district court (*id.* at D22-D24, D27), including the loan documents prepared by HF's own attorneys and the financial details of the Famolare building refinancing, amply supported the courts' findings that the transfer of the $1.5 million to Zinke and the additional cash transmitted to HF as part of the refinancing represented the routine making and repayment of a loan between commercially sophisticated parties. Compare, *e.g.*, *Brand* v. *Brand*, 811 F.2d 74, 77 (2d Cir. 1987) (fiduciary relationship and unjust enrichment generally prerequisite to imposition of constructive trust).

Similarly, the courts below properly rejected petitioner Stonehenge's attempt to impose a constructive trust on proceeds from the sale of the Fifth Avenue apartment. New York law requires that a party trace his property into any property or fund on which he seeks to impose a constructive trust. Pet. App. B5; see, *e.g.*, *Fur & Wool Trading Co.* v. *George I. Fox, Inc.*, 156 N.E. 670, 671 (N.Y. 1927). Stonehenge could trace its funds to the Famolare building (Pet. App. 5),

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As discussed above, the courts below properly held that the record in this case would not support a finding that Zinke was a fiduciary with respect to Stonehenge *or* HF. Moreover, the Court recently declined to address the question of a non-fiduciary's liability for knowing participation in the violation of fiduciary duties under ERISA. *Reich* v. *Continental Casualty Co.*, 115 S. Ct. 1104 (1995). Even if the question were properly presented, there would be no reason for a different result here.

not to the Zinke apartment.[6] And even if Stonehenge were able to frame a valid theory of "subrogation" to any claim that HF might have had against Zinke, it conceded below that such a claim would fail if HF itself could not recover. See C.A. App. 349; Pet. App. B5-B6, D33-D34. The courts below were entitled to rely on that concession. Compare Pet. 9-10.

Finally, there is no merit to petitioners' contention (Pet. 14-16) that the courts below erroneously required them to prove the existence of a fiduciary relationship. As petitioners conceded at trial (C.A. App. 251-252), the party seeking to establish a constructive trust in New York bears the burden of proving the existence of the underlying fiduciary relationship. Pet. App. D21; see, *e.g.*, *Cabellero* v. *Anselmo*, 759 F. Supp. 144, 147 (S.D.N.Y. 1991). Even if we assume that they are relevant here, none of the cases cited by petitioners involving ERISA fiduciaries holds to the contrary. See *Leigh* v. *Engle*, 727 F.2d 113, 138 (7th Cir. 1984) (defendants found to have breached fiduciary duties bore burden of separating profits from improperly commingled assets); *Whitfield* v. *Lindemann*, 853 F.2d 1298, 1305 (5th Cir. 1988) (assuming, without deciding, that defendants should bear burden of proving that a breach of duty did not cause loss), cert. denied, 490 U.S. 1089 (1989); *Donovan* v. *Cunningham*, 716 F.2d 1455, 1467-1468 & n.27 (5th Cir. 1983) (fiduciaries of employee stock ownership plan required to show they paid a fair price for securities purchased from

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[6] Petitioners' assertion (Pet. 11) that some of Stonehenge's funds were used to purchase the apartment has no foundation in the record.

employer), cert. denied, 467 U.S. 1251 (1984).[7] Petitioners cite no case in which a court required a defendant to prove that he was not a fiduciary.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[7] Petitioners also cite (Pet. 15-16) three earlier decisions rendered by the court below. The decision in this case does not conflict with any of those decisions. In *New York State Teamsters Council* v. *Estate of DePerno*, 18 F.3d 179, 180 (2d Cir. 1994), for example, the court required the plaintiffs to establish the defendants' violation of a fiduciary duty to an ERISA plan, before the burden shifted to the defendants to show factors mitigating damages. Even if the decisionswere in conflict, however, the matter would be one for resolution by the court of appeals itself. See *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957).